

**COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM**

**OVERSIGHT HEARING**

**“Iraqi Reconstruction: An Overview”**

**THURSDAY, FEBRUARY 15, 2007, 10:00 a.m.**

**ROOM 2154 RAYBURN HOUSE OFFICE BUILDING**

**REPUBLICAN STAFF BRIEFING MEMORANDUM**

On Thursday, February 15, 2007, at 10:00 a.m. in room 2154 of the Rayburn House Office Building, the Committee on Oversight and Government Reform will conduct a Full Committee oversight hearing on reconstruction and troop support contracting in Iraq. Under Chairman Tom Davis, the full Committee has engaged in continuous and vigorous oversight of contract activities in Iraq. The oversight has involved five hearings on the challenges of contracting in a war zone, numerous briefings from the agencies involved in the contracting efforts, as well as the review of thousands of documents the Committee had requested from relevant agencies over the last couple of years. Those efforts have been oriented towards contractor logistics support for the war effort as well as contracting activities related to the reconstruction program in Iraq. In addition, the Subcommittee on National Security, Emerging Threats and International Relations held numerous hearings over the past couple of years on Iraq war issues, including a June 13, 2006 hearing on the use of security contractors in Iraq.

The Majority states that this hearing will look at the performance of contractors in Iraq and the government’s oversight efforts. This week’s hearing will consist of representatives of oversight entities: The Government Accountability Office (GAO), the Special Inspector General for Iraq Reconstruction (SIGIR) and the Defense Contract Audit Agency (DCAA) all of whom had been originally scheduled to appear at last Wednesday’s hearing, entitled “Iraq Reconstruction: Reliance on Private Military Contractors and Status Report.” According to the Majority’s background memo, the hearing will focus on various audit reports issued by GAO and the SIGIR that find that the government does not have sufficient acquisition oversight workers to manage the huge support and reconstruction contracting effort in Iraq. These reports often depict cost overruns and performance difficulties. Many of the findings relate to the challenges that occurred in the early days of the rebuilding and support efforts. There are still major challenges, but things have improved in the last year or so.

## **BRIEF BACKGROUND ON CONTRACTING IN IRAQ**

After the conclusion of major conventional military actions in the U.S.-led coalition's war to change the regime in Iraq, there remained a continuing need to support our troops and civilians on the ground in Iraq with everything from logistics and engineering services, food preparation, laundry, housing, and construction in support of military operations. This support is in large part furnished by Kellogg, Brown and Root (KBR), a subsidiary of the Halliburton Company. We understand that over \$16 billion more has been expended on these efforts. At that same time, the U.S. embarked on a major effort to rebuild the infrastructure and government of the country. Since 2003, through various funds made available by Congress, the U.S. has provided about \$21 billion for the reconstruction effort.

### **Logistics Support Contracting**

KBR is the major prime contractor executing the Army's Logistical Civil Augmentation Program (LOGCAP). LOGCAP was established in 1985 to manage the use of various civilian contractors who perform services in support of DOD missions during times of war and other military mobilizations. LOGCAP has been used to support DOD missions from Somalia to Afghanistan to Iraq. It was used effectively during military operations in Bosnia and Kosovo. The effort in Iraq is the largest in history.

This particular contract held by KBR is the third iteration of the Army LOGCAP contract. The first was awarded to KBR in 1992, the second was awarded to DynCorp in 1994, and the current contract awarded to KBR in 2001. Despite the noise about political favoritism, all three contracts were awarded under competitive acquisitions prior to the commencement of the Bush Administration.

The LOGCAP contract was awarded on a cost-plus award fee basis. Such contracts provide that the contractor is only to be reimbursed for reasonable, allowable, and allocable costs incurred as prescribed in the contract. A cost-plus award fee contract provides financial incentives based on performance. The logistical needs of our military in Iraq and Kuwait are massive, time sensitive and ever changing. In order to meet these needs, KBR must be able to react swiftly. These requirements dictate the use of a cost-type contract. Cost-type contracts are commonly used where, as in Iraq, urgency and uncertainties do not permit costs to be estimated with sufficient accuracy to permit the use of fixed-price contracts.

Work under LOGCAP is based on task orders issued by the Army. These can be very large and complex. For example, task orders have been valued at up to \$5.2 billion. In order to meet the needs of the task order, KBR performs the work itself, negotiates for subcontractors, or uses a combination of the two.

Defense auditors – the Defense Contract Audit Agency (DCAA) - have properly criticized KBR for inadequate cost estimating and problems with its accounting and

documentation practices. There have been a number of critical issues over the last couple of years involving KBR, particularly concerning food services and the provision of oil and gas products. **These issues often arise in the context of cost-type contracts and are a part of the normal contract oversight process.** They were exacerbated here because of the large amounts of money involved and the extremely difficult conditions in Iraq. Most of these matters have been settled by the government's contracting officers. Currently, the program seems to be running more smoothly.

There has been an overriding issue in Iraq contracting regarding what is called the definitization of contracts or task orders. Definitization refers to the negotiations between the contractor and the Government to come up with an agreed upon cost estimate and specifications for the work to be accomplished. The majority of the task orders were definitized very late in the process, often after much or all of the work was completed. As this definitization process has been on-going, there was not much incentive for any contractor to control costs. While there is plenty of blame to go around for this situation – awful conditions, inadequate government oversight, requirements that changed continually and KBR's poor accounting system and practices - we understand that KBR has made progress on their bookkeeping, and the definitization process has improved significantly. A good portion of the cost issues have been settled with the contractor.

One thing to keep in mind is that the DCAA auditors work for the contracting officer. For example, the auditors make initial recommendations as to whether particular costs are appropriate. DCAA however, does not make the final decision as to whether a particular cost should be paid by the government. The contracting officer makes that decision after considering all of the circumstances, including business considerations and other matters including the challenges and urgency surrounding the performance of the contract. So be careful of huge figures thrown around by the Majority. They often are made up only of the audit recommendations, which may or may not ultimately be upheld by the contracting officer.

### **Reconstruction Contracting**

Since 2003, the reconstruction has been managed by a series of entities created in Iraq to administer the effort. The contracting efforts moved from humanitarian relief and restoration of basic services to large-scale infrastructure projects. The acquisition strategy for these projects was based on the use of large design-build construction contracts (under which a single firm is responsible for all aspects of the project: planning, design and construction) for the various sectors, such as electricity, public works/water, communication/transportation, buildings/education/ health, security/justice, agriculture, and oil and gas. These task order, cost-type contracts ranged in potential value from \$75 million for communications to \$1.2 billion for oil and gas restoration in the South.

Around 2004 after the initiation of these efforts, widespread concern was developing about the slow progress of much of the reconstruction work. Contract implementation was progressing at a snail's pace for a number of reasons, including the

lack of contracting professionals with the appropriate skills in Iraq, high turnover rates at all levels, and the deterioration of security conditions. The limited progress under the design-build process caused a shift in emphasis to smaller contract vehicles, including direct contracts with local Iraqi or regional firms. These new contracts were often awarded on a fixed-price basis for relatively small water, electrical, and school projects. Another aspect of the trend towards a smaller, more targeted approach was the establishment of special contracting programs, such as the Commander's Emergency Response Program for small local projects and Commander's Humanitarian Relief and Reconstruction Program for water and sewerage services in the Baghdad area.

Currently, approximately \$21 billion has been obligated for reconstruction out of various U.S. funds. The major funding authority expired at the end of October 2006. Nevertheless, a good deal of construction work will continue to be performed for the foreseeable future under those contracts whose funds have been obligated. As many of the reconstruction projects are completed, the responsible U.S. entities must implement transition plans to ensure that completed projects and related assets are turned over to the appropriate Iraqi officials, who will hopefully have the training and financial resources to sustain them.

While the U.S. has not been able to complete all of the projects that have been planned, the efforts are far from the unmitigated failure portrayed by the press and the Majority. **For example, 80 percent of the Iraq reconstruction projects have been completed properly, on time, and within budget. Sure there have been significant challenges. We would have liked to have completed more than about 80% of the planned water projects and 65% of the planned projects in the electricity sector.**

There are a number of reasons for the difficulties and delays. According to the Special Inspector General for Iraq Reconstruction (SIGIR), some of these include (1) inadequate cost estimates for many of the projects, (2) increased costs of materials, (3) high cost of contractor security along with project delays caused by intimidation and violence (according to a State Department estimate, direct and indirect costs of security represented 16 to 22% of the overall costs of major infrastructure reconstruction projects), (4) evolving reconstruction priorities and funding allocations, and (5) lack of oversight of reconstruction projects. Currently, a key priority is to ensure that the projects that are, or will be, completed are sustained, and that the Iraqis have the capacity to eventually take over the repair of their infrastructure.

Dialogue in our most recent hearing on Iraq reconstruction held in September 2006, was dominated by the SIGIR audit of the Baghdad Police College (BPC). Shortly after these BPC facilities went into operation, several issues arose with the sewage and drainage systems in the restrooms of the cadet barracks. In SIGIR's visits to the site subsequent to the audit, inspectors noted poor quality assessment and control mechanisms and shoddy repairs to the facilities using low-quality plumbing fixtures among other things. The government has already paid the contractor \$62 million for fully and partially completed work, and additional contracts with other firms in excess of \$8 million have been awarded to complete some of the construction work not finished by

initial contractor. Given that some of the deliverables have been removed from the scope of the work under the contract, this project, which was expected to cost \$73 million, will inevitably cost more and deliver less to the government.

More recently, SIGIR's January 2007 Quarterly Report to Congress highlighted poor contract administration by the Department of State's Office of Acquisition Management in its effort to provide Iraqi police training and support. The auditors found mind boggling waste as the State Department paid almost \$44 million for the manufacture and storage of a residential camp to house 1,040 police training and advisor personnel that has never been used because of security concerns. Further, SIGIR found that State may have spent another \$36.4 million for weapons and equipment, including armored vehicles, body armor and communications equipment that cannot be accounted for. Finally, SIGIR's findings here include unauthorized work on the aborted residential camp that for such things as VIP trailers and an Olympic-sized swimming pool, again that have never been used. So there is no doubt that challenges remain.

GAO has issued a series of recent reports on the need to improve our capacity to manage contractors in Iraq. GAO notes that our investments made through reconstruction and support contracts have not always resulted in the desired outcomes. Many reconstruction projects have fallen short of expectations and we have yet to completely resolve challenges in management and oversight of contractors in deployed locations. The underlying causes for these problems according to GAO include the lack of sufficiently focused high-level leadership, mismatches between requirements and resources, and an inadequate number of trained and acquisition and oversight personnel. While these challenges are not unique to Iraq, the instability of the environment with the corresponding security problems has greatly exacerbated the impact of problems. These problems have plagued the acquisition efforts from the beginning. Some of the challenges have been mitigated. For example, lack of planning and of a sufficient workforce resulted in the award of many of the early reconstruction contracts using other than full and open competition, while recent GAO reports show that, between October 2003 and March 2006, the vast majority of the more recent contract awards have been made on a competitive basis. But according to GAO, serious challenges remain, particularly the lack of sufficient numbers of acquisition management and oversight personnel with the right skills to direct, manage and assess contractor performance. In addition, GAO points out that we do not have data on the number of contract employees and the types of services they provide.

Finally, DCAA has issued a huge number of audit reports on \$51.8 billion worth of Iraq contracts. A number of these reports have recommended improvements in the reliability of contractor business systems such as cash management, management of subcontracts or documentation of proposed costs. According to DCAA, most of these issues have been resolved. As for the cost audits, DCAA has recommended reductions in proposed and billed costs of \$4.9 billion and identified \$5.1 billion of estimated costs that were not sufficiently supported. Most of the unsupported costs have been resolved.

## **WITNESSES**

First Panel: **Auditors**

**Mr. David Walker:** Comptroller General of the United States

**Mr. Stuart W. Bowen, Jr.:** Special Inspector General for Iraq  
Reconstruction

**Mr. William H. Reed:** Director, Defense Contract Audit Agency